

Private Foundation Expenditure Responsibility Requirements

Overview

Private foundation assets must be used exclusively for charitable purposes under U.S. law. Grants to organizations that are not U.S. public charities (or foreign equivalents), government entities or international organizations must comply with expenditure responsibility or “ER” requirements intended to ensure that the funds are used solely for charitable purposes. A failure to fulfill this obligation exposes the foundation and its management to potential tax penalties.

The ER rules require the foundation to:

- Conduct due diligence on the applicant before a grant is awarded (“Pre-Grant Inquiry”)
- Execute a written grant agreement that contains required terms and conditions that are non-negotiable
- Receive annual narrative/financial reports after the close of the grantee’s fiscal year
- Publicly disclose the grant amount and purpose on its annual information return

What is a Pre-Grant Inquiry?

Before a grant is awarded, the foundation will engage in due diligence to ensure that the applicant is capable of carrying out the project, safeguarding grant funds and reporting accurately on project activities and progress towards its goals.

The foundation may collect materials directly from the applicant or retain an advisor with financial/accounting experience to help carry out this analysis, which may include site visits by foundation or advisor staff. Most due diligence requests will cover the following:

- Organizational and governance documents and evidence of compliance with all applicable tax filing and registration requirements
- Internal policies and controls such as conflict of interest policies, procedures for tracking employee time devoted to a project and expense reimbursement policies
- Financial viability
- Adequacy of staffing levels and qualifications of key employees
- Capacity to manage the scale and complexity of the anticipated project, including financial/accounting experience
- Access to intellectual property necessary to carry out the project, and the appropriate management of technologies being funded under the project and associated intellectual property aimed at ensuring the long-term Global Access objectives (see below) can be accomplished

The foundation may also verify due diligence findings during the life of the grant, as well as conduct grant evaluation site visits or other analyses to confirm that grant funds are being used as required.

What are key terms in the foundation's grant agreement?

The foundation's grant agreement contains the terms and conditions required under U.S. law for ER grants, in addition to other legal and programmatic requirements. Key terms include the following:

- Limitation on use of grant funds for charitable purposes, including an obligation to compensate the foundation for any funds not used for the stated purpose of the grant
- Requirement that grant funds be maintained in a segregated fund or account
- Requirement that subgrants, if permitted, be made consistent with ER requirements (including appropriate due diligence, oversight and reporting by the applicant organization)
- Maintenance of grant-related records
- Annual and final narrative and financial reports based on cash accounting
- Prohibition against using funds for lobbying, electioneering and noncharitable purposes
- Requirement to return any unused funds and income generated from the funds at the end of the grant period

Additional terms may include limitations on the purchase of capital equipment, specific record-keeping requirements for time sheets and other expenses and Global Access provisions (see below).

What is required in the annual and final ER reports?

The foundation will provide templates for the annual and final reports at the end of each fiscal year during the life of the grant for the organization to complete. The reports provide a narrative description of the progress that has been made toward the purposes of the project, a detailed breakdown of how the grant funds were used on the basis of cash amounts expended in comparison to the approved budget and certification that grant funds have been used properly.

What information is publicly disclosed by the foundation?

The foundation's annual IRS Form 990-PF information return identifies each ER grantee, the amount and purpose of each ER grant and amounts expended. Any suspected or actual diversions of funds (i.e. funds used for any purpose other than the stated charitable purpose of the grant) must be publicly disclosed.

What is Global Access?

Where the nature of the project requires, the foundation may establish "Global Access" requirements to achieve the charitable purposes of the grant and benefit disadvantaged populations, including those in the developing world. Generally, Global Access requires that (i) knowledge and information gained from the project be promptly and broadly disseminated and (ii) the technology and products developed with grant funds be made available and accessible at an affordable price to people most in need within developing countries or in support of the U.S. educational system and public libraries, as applicable to the project.

Other Frequently Asked Questions

Here are some questions that have been raised by other applicants:

Can we use a calendar year or special project year in preparing our proposal budget and for providing the foundation with regular reports during the life of the grant?

No, unless it coincides with your fiscal year. ER rules require the foundation to receive annual reports from grantees based on the organization's fiscal year. Reports are typically due three months after the close of the organization's books. In order to make these reports useful, it is important for the grant proposal and budget to follow the organization's fiscal year, even though this may result in an initial short year. Due to this ER requirement, it is not uncommon for the foundation to receive a report reflecting only a few months of limited initial activity at the start of a grant project.

Can an organization calculate staff time and cost through averages or estimates?

No. Foundation funds must be used exclusively for charitable purposes and safeguarding foundation funds requires accurate tracking of expenses incurred by employees and other staff on the project, including actual rates for each employee.

Can grant funds be used to purchase capital equipment that is used for multiple purposes?

No. Capital equipment (i.e., equipment with a per-item cost of more than \$5,000) that is purchased with foundation funds must be used exclusively for the project. If the equipment's useful life exceeds the project period, special measures regarding the disposition of the equipment may be required.

Are financial reports and audits necessary?

Yes. Reviewing the financial state of an organization is considered a necessary component of an adequate pre-grant inquiry. Audited financial statements and related materials provide important insight into an organization's internal capacity. However, the audit requirement may be waived for smaller sized or startup organizations that would not typically be expected to undergo an annual audit.

How often does the foundation audit its for-profit grantees?

It depends. Grantees are selected for audit through a random selection process and risk-based approach. We do site visits and financial reviews for many of our for profit grantees, particularly those with limited experience with private foundation grants. These reviews, or grant expenditure evaluations are often performed during the second year of a grant project to assess how the grant is performing.

Are we required to report any income earned on grant funds?

Yes. You are required to report on any income earned on grant funds, such as interest and/or currency gains (and losses). Further, any income earned must be used for purposes of the project.